

CITY OF FROSTBURG, MARYLAND
FINANCIAL REPORT
FOR THE YEAR ENDED JUNE 30, 2011

HM Huber, Michaels
& Company

Certified Public Accountants

CITY OF FROSTBURG, MARYLAND

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Certified Public Accountants

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INDEPENDENT AUDITORS' REPORT

Mayor and City Council
City of Frostburg, Maryland

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the remaining fund information of City of Frostburg, Maryland, as of and for the year ended June 30, 2011, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of City of Frostburg, Maryland's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall basic financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the remaining fund information of the City of Frostburg, Maryland, as of June 30, 2011, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 15, 2011, on our consideration of the City of Frostburg, Maryland's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 – 15, the budgetary comparison information on pages 44 – 45, and the "Schedule of Funding Progress – Other Post-Employment Benefit Plan Contributions" on page 46 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Herbert, Richard & Company

Cumberland, Maryland
November 15, 2011

CITY OF FROSTBURG, MARYLAND
MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)
JUNE 30, 2011

City of Frostburg Management's Discussion and Analysis

As management of the City of Frostburg, we offer readers of the City of Frostburg's financial statements this narrative overview and analysis of the financial activities of the City of Frostburg for the fiscal year ended June 30, 2011. We encourage readers to read the information presented here in conjunction with additional information that we have furnished in the city's financial statements, which follow this narrative.

Financial Highlights

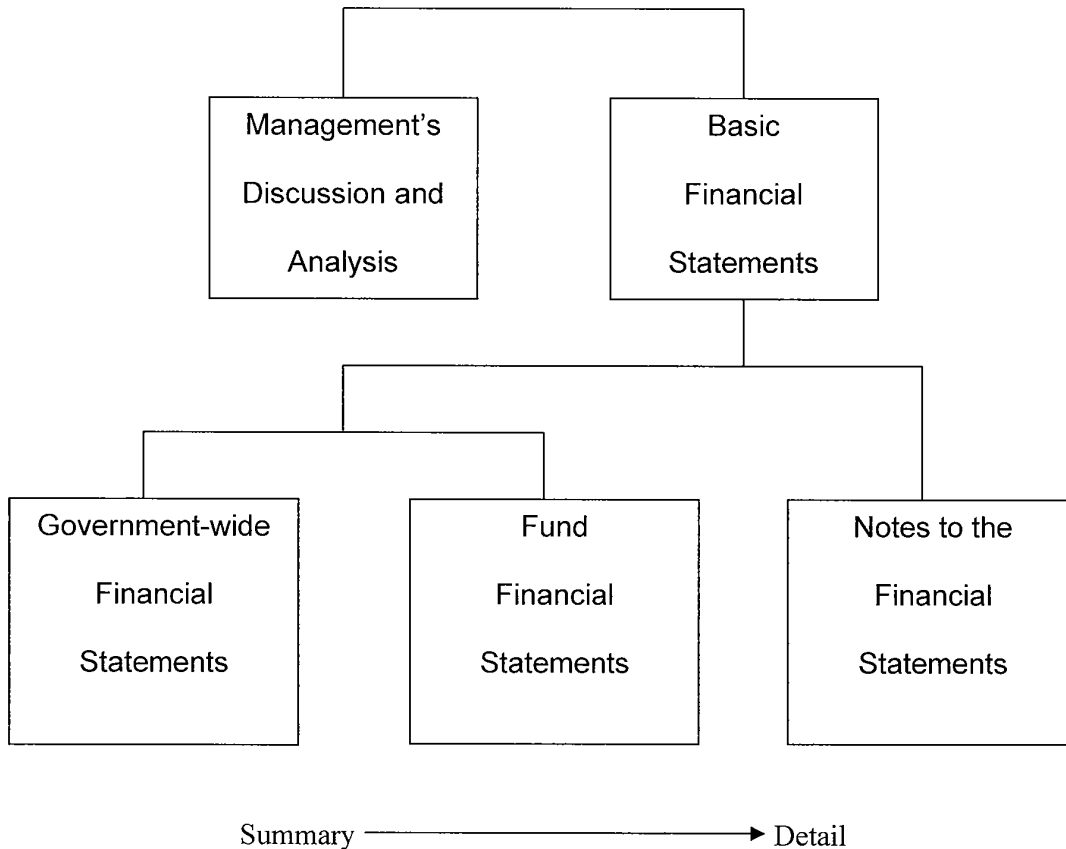
- The assets of the City of Frostburg exceeded its liabilities at the close of the fiscal year by \$28,348,208.
- The government's total net assets increased by \$1,706,619, primarily due to increases in the government-type and business-type activities net assets.
- As of the close of the current fiscal year, the City of Frostburg's governmental funds reported combined ending fund balances of \$2,616,439, an increase of \$93,568 in comparison with the prior year. Approximately 100 percent of this total amount, or \$2,370,372, is available for spending at the government's discretion.
- At the end of the current fiscal year, unrestricted fund balance for the General Fund was \$2,408,669, or 64 percent of total general fund expenditures for the fiscal year.
- The City of Frostburg's total debt decreased by \$218,367, or 3 percent during the current fiscal year.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the City of Frostburg's basic financial statements. The city's basic financial statements consist of three components; 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements (see Figure 1). The basic financial statements present two different views of the city through the use of government-wide statements and fund financial statements. In addition to the basic financial statements, this report contains other supplemental information that will enhance the reader's understanding of the financial condition of the City of Frostburg.

Required Components of Annual Financial Report

Figure 1



Basic Financial Statements

The first two statements (pages 16 & 17) in the basic financial statements are the **Government-wide Financial Statements**. They provide both short and long-term information about the City of Frostburg financial status.

The next statements (pages 18 - 24) are **Fund Financial Statements**. These statements focus on the activities of the individual parts of the city government. These statements provide more detail than the government-wide statements. There are three parts to the Fund Financial Statements: 1) the governmental fund statements; 2) the budgetary comparison statements; and 3) the proprietary fund statements.

The next section of the basic financial statements is the notes (pages 25 – 43). The notes to the financial statements explain in detail some of the data contained in those

Management Discussion and Analysis

City of Frostburg

statements. After the notes, supplemental information is provided to show details about the city's individual funds. Budgetary information required by the General Statutes also can be found in this part of the statements.

Government-wide Financial Statements

The government-wide financial statements are designed to provide the reader with a broad overview of the city finances, similar in format to a financial statement of a private-sector business. The government-wide statements provide short and long-term information about the city financial status as a whole.

The two government-wide statements report the city's net assets and how they have changed. Net assets are the difference between the city's total assets and total liabilities. Measuring net assets is one way to gauge the city's financial condition.

The government-wide statements are divided into two categories: governmental activities and business-type activities. The governmental activities include most of the city's basic services such as public safety, streets, parks and recreation, and general administration. Taxes and state and federal grant funds finance most of these activities. The business-type activities are those that the city charges customers to provide. These include the water, sewer and refuse services offered by the City of Frostburg.

The government-wide financial statements are on pages 16 and 17 of this report.

Fund Financial Statements

The fund financial statements provide a more detailed look at the city's most significant activities. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City of Frostburg, like all other governmental entities in Maryland, uses fund accounting to ensure and reflect compliance (or non-compliance) with finance-related legal requirements, such as the General Statutes or the city's budget ordinance. All of the funds of City of Frostburg can be divided into two categories: governmental funds and proprietary funds.

Governmental Funds – Governmental funds are used to account for those functions reported as governmental activities in the government-wide financial statements. Most of the city's basic services are accounted for in governmental funds. These funds focus on how assets can readily be converted into cash and what monies are left at year-end that will be available for spending in the next year. Governmental funds are reported using an accounting method called modified accrual accounting that provides a short-term spending focus. As a result, the governmental fund financial statements give the reader a detailed short-term view that helps him or her determine if there are more or less financial resources available to finance the city's programs. The relationship between governmental activities (reported in the Statement of Net Assets and the Statement of

Management Discussion and Analysis

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Activities) and governmental funds is described in a reconciliation that is a part of the fund financial statements.

The City of Frostburg adopts an annual budget for its General Fund, as required by the charter. The budget is a legally adopted document that incorporates input from the citizens of the city, the management of the city, and the decisions of the Mayor & Council about which services to provide and how to pay for them. It also authorizes the city to obtain funds from identified sources to finance these current period activities. The budgetary statement provided for the General Fund demonstrates how well the city complied with the budget ordinance and whether or not the city succeeded in providing the services as planned when the budget was adopted. The budgetary comparison statement uses the budgetary basis of accounting and is presented using the same format, language, and classifications as the legal budget document. The statement shows four columns: 1) the original budget as adopted by the Mayor & Council; 2) the final budget as amended by the Mayor & Council; 3) the actual resources, charges to appropriations, and ending balances in the General Fund; and 4) the difference or variance between the final budget and the actual resources and charges. To account for the difference between the budgetary basis of accounting and the modified accrual basis, a reconciliation showing the differences in the reported activities is shown at the end of the budgetary statement.

Proprietary Funds – The City of Frostburg has two different kinds of proprietary funds. Enterprise Funds are used to report the same functions presented as business-type activities in the government-wide financial statements. The City of Frostburg uses enterprise funds to account for its water, water surcharge, sewer and refuse activity. These funds are the same as those functions shown in the business-type activities in the Statement of Net Assets and the Statement of Activities.

Special Revenue Funds are an accounting device used to accumulate and allocate costs internally among the functions of the City of Frostburg. The city uses a special revenue fund to account for its Community Development Block Grant activity. Because this activity benefits predominantly governmental rather than business-type activities, the special revenue fund has been included within the governmental activities in the government-wide financial statements.

Notes to the Financial Statements – The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements are on pages 25 - 43 of this report.

Government-Wide Financial Analysis

The government-wide financial statements include the Statement of Net Assets. The Statement of Net Assets presents information on all of the City of Frostburg's assets and liabilities, with the difference between the two reported as Net Assets. Over time,

Management Discussion and Analysis

City of Frostburg

increases or decreases in net assets may serve as a useful indicator of whether the financial position of the City is improving or deteriorating. The Statement of Activities is also included in the government-wide financial statements. The focus of the Statement of Activities is to show how the government's assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave). The government-wide statements include the Statement of Net Assets and the Statement of Activities and can be found on pages 16 - 17 of this report.

The City of Frostburg's Net Assets
Figure 2

	Governmental Activities		Business-Type Activities		Total	
	2011	2010	2011	2010	2011	2010
Current and other assets	\$ 3,045,795	\$ 2,808,169	\$ 1,993,819	\$ 1,866,059	\$ 5,039,614	\$ 4,674,228
Non-current assets	191,123	87,570	137,110	144,608	328,233	232,178
Capital assets	9,033,295	8,969,529	26,126,899	24,602,305	35,160,194	33,571,834
Total assets	12,270,213	11,865,268	28,257,828	26,612,972	40,528,041	38,478,240
Long-term liabilities	1,437,556	1,503,858	8,601,529	8,810,039	10,039,085	10,313,897
Other liabilities	408,840	277,231	1,731,908	1,245,523	2,140,748	1,522,754
Total liabilities	1,846,396	1,781,089	10,333,437	10,055,562	12,179,833	11,836,651
Net assets:						
Invested in capital assets, net of related debt	8,876,784	8,799,529	17,171,833	15,266,207	26,048,617	24,065,736
Restricted	387,339	258,764	-	-	387,339	258,764
Unrestricted	1,159,694	1,025,886	752,558	1,291,203	1,912,252	2,317,089
Total net assets	\$ 10,423,817	\$ 10,084,179	\$ 17,924,391	\$ 16,557,410	\$ 28,348,208	\$ 26,641,589

As noted earlier, net assets may serve over time as one useful indicator of a government's financial condition. The assets of the City of Frostburg exceeded liabilities by \$28,348,208 as of June 30, 2011. The majority of the net assets are capital assets. These capital assets are used to provide services to citizens; consequently, these assets are not available for future spending. Although the City of Frostburg's investment in its capital assets is reported net of the outstanding related debt, the resources needed to repay that debt must be provided by other sources, since the capital assets cannot be used to liquidate these liabilities. An additional portion of the City of Frostburg's net assets (1%) represents resources that are subject to external restrictions on how they may be used.

Management Discussion and Analysis

City of Frostburg

The city's total net assets increased by \$1,706,619 for the fiscal year ended June 30, 2011.

Several particular aspects of the City financial operations positively influenced the increase in total governmental net assets:

- Increase in property tax revenues.
- Capital contributions of land and property.
- The grant funding received for the Sewer Fund CSO projects.
- The grant funding received for the Water Transmission Line Replacement project.

The City of Frostburg's Changes in Net Assets
Figure 3

		Governmental Activities		Business-Type Activities		Total	
		2011	2010	2011	2010	2011	2010
Revenues:							
Program revenues:							
Charges for services	\$	309,902	\$ 291,194	\$ 3,898,430	\$ 3,957,773	\$ 4,208,332	\$ 4,248,967
Operating grants and contributions		321,577	411,035	-	-	321,577	411,035
Capital grants and contributions		119,302	318,037	1,788,455	1,228,466	1,907,757	1,546,503
General revenues:							
Property taxes		2,113,118	1,958,061	-	-	2,113,118	1,958,061
Other taxes		709,204	819,934	-	-	709,204	819,934
Other		236,215	170,879	108,115	(5,393)	344,330	165,486
Total revenues		3,809,318	3,969,140	5,795,000	5,180,846	9,604,318	9,149,986
Expenses:							
General government		423,930	427,978	-	-	423,930	427,978
Public safety		1,476,800	1,406,955	-	-	1,476,800	1,406,955
Public works		955,193	979,817	-	-	955,193	979,817
Recreation and parks		519,372	469,937	-	-	519,372	469,937
Community development		162,942	159,574	-	-	162,942	159,574
Code enforcement		161,816	113,305	-	-	161,816	113,305
Interest on long-term debt		71,779	76,741	-	-	71,779	76,741
Water, sewer and garbage		-	-	4,125,867	3,887,952	4,125,867	3,887,952
Total expenses		3,771,832	3,634,307	4,125,867	3,887,952	7,897,699	7,522,259
Change in net assets before transfers		37,486	334,833	1,669,133	1,292,894	1,706,619	1,627,727
Transfers		302,152	266,370	(302,152)	(266,370)	-	-
Change in net assets		339,638	601,203	1,366,981	1,026,524	1,706,619	1,627,727
Net assets, July 1		10,084,179	9,482,976	16,557,410	15,530,886	26,641,589	25,013,862
Net assets, June 30	\$	10,423,817	\$ 10,084,179	\$ 17,924,391	\$ 16,557,410	\$ 28,348,208	\$ 26,641,589

Management Discussion and Analysis

City of Frostburg

Governmental activities: Readers will note the Statement of Activities is significantly different than a typical Statement of Revenues, Expenses and Changes in Fund Balance. Expenses are listed in the first column with revenues for that particular program reported to the right. The result is a Net Revenue/(Expense). The reason for this format is to highlight the relative financial burden of each of the functions on the City's taxpayers. It also identifies how much each function draws from the general revenues or if it is self-financing through fees and grants.

Governmental activities increased the city's net assets by \$339,638. The key elements of this increase are as follows:

- The increase in property tax revenues.
- Contribution of house in Midlothian.
- Contribution of land on Water Street.

Business-type activities: Business-type activities increased the City of Frostburg's net assets by \$1,366,981. The key elements of this increase are as follows:

- The grant funding received for the W. College Avenue CSO project.
- The grant funding received for the Water Transmission Line Replacement Project.

Financial Analysis of the City Funds

As noted earlier, the City of Frostburg uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental Funds: The focus of the City of Frostburg's governmental funds is to provide information on near-term inflows, outflows, and balances of usable resources. Such information is useful in assessing the City of Frostburg's financing requirements. Specifically, unassigned fund balance can be a useful measure of a government's net resources available for spending at the end of the fiscal year.

The general fund is the chief operating fund of the City of Frostburg. At the end of the current fiscal year, unassigned fund balance of the General Fund was \$2,370,372, while total fund balance reached \$2,616,439. As a measure of the general fund's liquidity, it may be useful to compare both unassigned fund balance and total fund balance to total fund expenditures.

At June 30, 2011, the governmental funds of the City of Frostburg reported a combined fund balance of \$2,619,439, a 4 percent increase over last year. Included in this change in fund balance is an increase in fund balance in the General Fund and in fund balance in the Special Revenue Fund.

Management Discussion and Analysis

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General Fund Budgetary Highlights: During the fiscal year, the Mayor & City Council publicly amended the budget. Generally, budget amendments fall into one of three categories: 1) amendments made to adjust the estimates that are used to prepare the original budget ordinance once exact information is available; 2) amendments made to recognize new funding amounts from external sources, such as Federal and State grants; and 3) increases in appropriations that become necessary to maintain services.

- General Fund revenues were on budget target except for grant income of \$197,496 which was greater than expected and not budgeted. General fund expenditures were on budget target except for public works, street department and recreation department expenses which were greater than originally estimated.
- The City was able to comply with its budgetary requirements.

Proprietary Funds: The City's proprietary funds provide the same type of information found in the government-wide statements but in more detail. Unrestricted net assets of the Water, Water Surcharge, Sewer and Garbage Funds at the end of the fiscal year amounted to \$752,558. The total increase in net assets from current year operations was \$1,366,981. Other factors concerning the finances of these funds have already been addressed in the discussion of the City's business-type activities.

Capital Asset and Debt Administration

Capital assets: The City of Frostburg's investment in capital assets for its governmental and business-type activities as of June 30, 2011 totals \$35,160,194 (net of accumulated depreciation). These assets include buildings, roads, land, machinery and equipment, park facilities, and vehicles.

Major capital asset transactions during the year include the following additions and deletions:

- Completion of the West College Avenue AB CSO project of \$1,050,639.
- Work in progress on the West College Avenue CDE CSO project of \$263,551.
- Completion of the Water Transmission Line Replacement project of \$1,140,645.
- Work in progress on Phase VII CSO design project of \$117,424.
- Completion of 2010/11 street paving of \$196,212.
- Completion of computer upgrades at Water Treatment Plant of \$52,268.
- Work in progress of the Hydro Electric project of \$172,346.
- Work in progress of system upgrade at Piney Dam of \$14,055.
- Work in progress of the City Square parking lot of \$54,739.
- Donation of .772 acres adjacent to Frostburg Armory of \$49,834.
- Donation of house at 11711 Coleman Road of \$31,051.
- Purchase of 2 Kubota zero turn mowers of \$20,000.
- Purchase of 2 pickup trucks of \$40,671.

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The City of Frostburg's Capital Assets
Figure 4

	(net of depreciation)					
	Governmental Activities		Business-Type Activities		Total	
	2011	2010	2011	2010	2011	2010
Land and construction in progress	\$ 2,170,602	\$ 2,045,223	\$ 622,641	\$ 451,555	\$ 2,793,243	\$ 2,496,778
Buildings and systems	1,834,493	1,882,264	4,379,130	4,648,957	6,213,623	6,531,221
Improvements other than buildings	494,121	538,865	7,069,853	7,113,453	7,563,974	7,652,318
Machinery and equipment	516,106	533,378	445,824	473,425	961,930	1,006,803
Infrastructure	4,017,973	3,969,799	13,609,450	11,914,915	17,627,423	15,884,714
Total	<u>\$ 9,033,295</u>	<u>\$ 8,969,529</u>	<u>\$ 26,126,898</u>	<u>\$ 24,602,305</u>	<u>\$ 35,160,193</u>	<u>\$ 33,571,834</u>

Additional information on the City's capital assets can be found in note 5 of the Basic Financial Statements.

Long-term Debt. As of June 30, 2011 the City of Frostburg had total bonded debt outstanding of \$10,115,066. Of this, \$1,160,000 is debt backed by the full faith and credit of the City. The remainder of the City's debt represents bonds secured solely by specified revenue sources.

The City of Frostburg's Outstanding Debt
General Obligation and Revenue Bonds
Figure 5

	Governmental Activities		Business-type Activities		Total	
	2011	2010	2011	2010	2011	2010
General obligation bonds	\$ 1,160,000	\$ 1,205,000			\$ 1,160,000	\$ 1,205,000
Revenue bonds			\$ 8,955,066	\$ 9,128,433	\$ 8,955,066	\$ 9,128,433
Total	<u>\$ 1,160,000</u>	<u>\$ 1,205,000</u>	<u>\$ 8,955,066</u>	<u>\$ 9,128,433</u>	<u>\$ 10,115,066</u>	<u>\$ 10,333,433</u>

The City of Frostburg's total debt decreased by \$218,367 (2%) during the past fiscal year. Debt principal payments during the past fiscal year were \$5,613,366.

Additional information regarding the City of Frostburg's long-term debt can be found in note 6 beginning on page 35 of this report.

Management Discussion and Analysis

City of Frostburg

Economic Factors

1. Frostburg State University

FSU remains the largest employer in the City of Frostburg. It is still one of the largest drivers in the regional Mountain Maryland economy. The enrollment is stable, especially among returning students and transfers students. While every other campus in the University System of Maryland has been required to layoff/terminate staff at all levels to balance their budgets during this current Great Recession, FSU has been able to avoid all layoffs.

During the last two fiscal years, FSU has invested \$1 million a year to renovate some of the 1960's vintage dorms. In the next fiscal year, FSU will begin a major capital project for the planned CCIT Building on the site of the current Tawes Hall. Demolition of Tawes will be the first step prior the construction of the new complex. FSU has also planned a new 425 bed residential facility in the near future.

2. Allegany Business Center at Frostburg State University (ABC @ FSU)

The next generation of development is now under construction. It will involve building a 6,000 square foot demonstration facility that will be completely "off the grid". It will use only electrical power generated by solar and wind and will use geo-thermal systems for heating and cooling. FSU is taking the lead in attempting to attract the necessary funding for the construction. Completion of the project will make FSU a leader in practical alternative energy design for homes and commercial properties.

3. Main Street/Commercial Redevelopment

Crestmont Men's Clothing store was restored following a devastating fire and the business reopened in a stunning new store. The Prichard Building, gutted in the same fire, is undergoing a slow but steady reconstruction.

The owners of the Frostburg National Bank Building have invested in restoration of the first floor interior and upgrading the second floor while marketing the facility for commercial tenants.

Other private investments have occurred at several Main Street buildings and the City completed a new 18 space parking lot to support the businesses on Main Street, Broadway and Water Street. New businesses, both retail and professional services, located in the Main Street area during the year.

The City and affiliated agencies have continued toward more success with the Arts and Entertainment District as well as expanding and improving special events like the Arts Walks, Derby Day, Cruisin Main Street and Storybook Holiday. A number of groups are discussing ways to improve and expand the visits by tourists from the Western Maryland

Management Discussion and Analysis

City of Frostburg

Scenic Railroad and the Great Allegheny Passage Trail, including transportation and events to draw them to the Main Street business area.

4. Housing Development

The Woda Company completed construction of their 50 unit senior housing project along Braddock Road and began leasing. This project has become the leading edge of a much larger investment to improve the infrastructure at this interchange off of I-68 to promote more commercial development.

The City has worked with the lenders on the Prichard Farm Project as they took possession of the development and began planning the next possible steps in revitalizing that project. The national housing recession and resulting bank difficulties have slowed progress. Several other single family subdivisions remain in the planning stages with the City's Department of Community Development.

In general residential values remain stronger in the Frostburg market, due in large measure to FSU. Both the homes of employees and the student rentals continue to provide a more solid base for residential pricing and activity than seen elsewhere in the Allegany County region.

5. Regional Employers

The City of Frostburg is also affected by the progress and success of larger employers within the City and the Region. First are those located in the City. They include:

- Frostburg State University – FSU remains the largest economic engine in all of Western Maryland, especially in Frostburg. The relocation of several FSU offices and a satellite Book Store to Main Street brings a dramatic new and direct impact on the heart of the community's retail business area.
- ACS, a Xerox Company - This customer service call center has well over 500 employment situations, many part-time. They continue to offer employment opportunities in Frostburg and remain a growing, public company with operations across the nation and in other counties
- Active Network/Infospherix – This is a special customer service call center that employs up to 500 people during their busy season. They contract with many public agencies and private businesses. The special niche has been as a full service reservation center for State and Federal camp grounds. The company has continued to succeed and grow.
- Hamilton Communications/Maryland RELAY – This project is located in the former Micro-Integration Building in the Frostburg Industrial Park. The firm is the contractor to the State of Maryland providing RELAY services to persons with hearing disabilities.

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- Sierra Hygiene - This firm, headquartered in California, leases the former Kreative Plastics Building as a fabrication plant for commercial paper products. They employ between 15 and 25 people.

In addition a number of other firms in the region are affecting Frostburg. They include:

- Western Maryland Health System – The Health System is the largest employer in Allegany County. Numerous Frostburg residents work at the new Regional Medical Center (Hospital) in Cumberland or in their numerous clinics and their Rehab Center and Nursing Home, which is located in Frostburg.
- ATK Tactical Systems – This major defense contractor located in Mineral County has continued to grow and receive Federal contracts for their products and for improvements to their facilities. Their employment ranges between 700 and 800 high paying jobs.
- NewPage – The Luke Fine Papers Mill of NewPage now employs less than 900 people, many living in Frostburg. These employees enjoy good salaries, however changes in the papers industry continue across the nation, including the Luke Mill. During the year NewPage filed for Chapter 11 Bankruptcy to reorganize their debt. Consistent statements have indicated that the Luke Mill is not at risk as a result of these transactions.

Budget Highlights for the Fiscal Year Ending June 30, 2012

Governmental Activities: Property taxes are expected to increase by 1 percent. The City will use these increases to finance programs currently in place.

Budgeted expenditures in the General Fund are expected to increase less than 1 percent. The increase is a result of an increase in the annual appropriation to the Frostburg Fire Department.

The State of Maryland budget reductions the City of Frostburg experienced in Fiscal Year Ending June 30, 2011 will continue.

Business – type Activities: The water and sewer rates, which were revised effective July 1, 2009, will be unchanged. All other water surcharge and garbage rates will remain the same. Fees for tap connections and meters will be unchanged. The CSO surcharge rate will increase for all City customers.

Capital projects budgeted include the continuation of the combined sewer overflow elimination projects with the completion of the West College Avenue/Linden Street CSO project, Phase VIIA-Taylor/Mechanic Street CSO Project in the Sewer Fund and a small-

Management Discussion and Analysis
City of Frostburg

head hydroelectric turbine and related improvements at the supply dam in the Water Surcharge Fund.

Requests for Information

This report is designed to provide an overview of the City finances for those with an interest in this area. Questions concerning any of the information found in this report or requests for additional information should be directed to the Director of Finance, Candace R. Sandvick, P.O. Box 440, Frostburg, MD 21532, 301-689-6000 x13, csandvick@allconet.org.

CITY OF FROSTBURG, MARYLAND

STATEMENT OF NET ASSETS
JUNE 30, 2011

	Primary Government		
	Governmental Activities	Business-type Activities	Total
ASSETS			
Current Assets:			
Cash and cash equivalents	\$ 1,967,341	\$ 1,248,857	\$ 3,216,198
Cash and cash equivalents - restricted	9,363	-	9,363
Certificate of deposit	94,437	-	94,437
Accounts receivable	258,819	1,416,634	1,675,453
Prepaid expenses	32,497	11,666	44,163
Internal balances	683,338	(683,338)	-
Total Current Assets	<u>3,045,795</u>	<u>1,993,819</u>	<u>5,039,614</u>
Capital Assets			
Non-depreciable	2,170,602	622,641	2,793,243
Depreciable, net of accumulated depreciation	6,862,693	25,504,258	32,366,951
Total Capital Assets, net of accumulated depreciation	<u>9,033,295</u>	<u>26,126,899</u>	<u>35,160,194</u>
Non-current Assets			
Bond & loan costs, net of accumulated amortization	15,750	137,110	152,860
Notes receivable	175,373	-	175,373
Total Non-current Assets	<u>191,123</u>	<u>137,110</u>	<u>328,233</u>
TOTAL ASSETS	<u>\$ 12,270,213</u>	<u>\$ 28,257,828</u>	<u>\$ 40,528,041</u>
LIABILITIES			
Current Liabilities:			
Accounts payable and accrued expenses	\$ 302,458	\$ 1,133,573	\$ 1,436,031
Salaries and benefits payable	51,382	19,339	70,721
Sanitary Commission payable	-	70,000	70,000
Current portion of long-term debt	55,000	508,996	563,996
Total Current Liabilities	<u>408,840</u>	<u>1,731,908</u>	<u>2,140,748</u>
Noncurrent Liabilities:			
Compensated absences	307,609	146,512	454,121
Accrued post employment health insurance	24,947	8,947	33,894
Long-term debt	1,105,000	8,446,070	9,551,070
Total Noncurrent Liabilities	<u>1,437,556</u>	<u>8,601,529</u>	<u>10,039,085</u>
TOTAL LIABILITIES	<u>1,846,396</u>	<u>10,333,437</u>	<u>12,179,833</u>
NET ASSETS			
Invested in capital assets, net of related debt	8,876,784	17,171,833	26,048,617
Restricted	407,339	-	407,339
Unrestricted	1,139,694	752,558	1,892,252
TOTAL NET ASSETS	<u>\$ 10,423,817</u>	<u>\$ 17,924,391</u>	<u>\$ 28,348,208</u>

The accompanying notes are an integral part of these financial statements.

CITY OF FROSTBURG, MARYLAND

**STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2011**

Function/Programs	Expenses	Program Revenues		Net (Expense) Revenue and Changes in Net Assets		
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government	
					Governmental Activities	Business-type Activities
Primary Government						
Governmental Activities:						
General government	\$ 423,930	\$ 206,540	\$ 48,709	\$ -	\$ (168,681)	\$ -
Public safety	1,476,800	27,155	120,145	-	(1,329,500)	-
Public works	955,193	-	25,759	119,302	(810,132)	-
Recreation and parks	519,372	74,535	2,538	-	(442,299)	-
Community development	162,942	-	124,426	-	(38,516)	-
Code enforcement	161,816	9,400	-	-	(152,416)	-
Interest on long-term debt	71,779	-	-	-	(71,779)	-
Total Governmental Activities	3,771,832	317,630	321,577	119,302	(3,013,323)	-
Business-type Activities:						
Water	1,165,285	1,139,769	-	295,009	-	269,493
Sewer	1,502,315	1,498,937	-	829,919	-	826,541
Water Surcharge	1,121,000	871,765	-	663,527	-	414,292
Garbage	337,267	387,959	-	-	-	50,692
Total Business-type Activities	4,125,867	3,898,430	-	1,788,455	-	1,561,018
Total Primary Government	\$ 7,897,699	\$ 4,216,060	\$ 321,577	\$ 1,907,757	(3,013,323)	1,561,018
General Revenues:						
Taxes						
Net property taxes					2,113,118	-
Income taxes					447,969	-
Highway use tax					33,954	-
Hotel motel tax					140,747	-
Admission taxes					86,534	-
Rental income					84,103	-
Licenses and permits					39,350	-
Interest earnings					7,418	1,025
Miscellaneous revenues					7,531	-
Timber Sales					-	117,500
Capital Contributions					80,885	-
Gain (loss) on disposal of fixed assets					9,200	(10,410)
Transfers					302,152	(302,152)
Total General Revenues, Special Items, Extraordinary Items and Transfers					3,352,961	(194,037)
Change in Net Assets					339,638	1,366,981
Net Assets - July 1, 2010					10,084,179	16,557,410
Net Assets - June 30, 2011					\$ 10,423,817	\$ 17,924,391
						\$ 28,348,208

The accompanying notes are an integral part of these financial statements.

CITY OF FROSTBURG, MARYLAND

BALANCE SHEET
GOVERNMENTAL FUNDS
JUNE 30, 2011

	General Fund	Special Revenue	Total Governmental Funds
ASSETS			
Cash and cash equivalents	\$ 1,739,779	\$ 227,562	\$ 1,967,341
Cash and cash equivalents - restricted	9,363	-	9,363
Certificate of deposit	94,437	-	94,437
Accounts receivable	258,819	-	258,819
Prepaid expenses	32,497	-	32,497
Interfund receivables	684,163	-	684,163
TOTAL ASSETS	\$ 2,819,058	\$ 227,562	\$ 3,046,620
LIABILITIES AND FUND BALANCES			
LIABILITIES			
Accounts payable and accrued expenses	\$ 254,098	\$ 18,968	\$ 273,066
Salaries and benefits payable	51,382	-	51,382
Deferred revenues	104,909	-	104,909
Interfund payables	-	824	824
TOTAL LIABILITIES	410,389	19,792	430,181
FUND BALANCES			
Nonspendable - Prepaid expenses	32,497	-	32,497
Restricted - Community Development Block Grants	-	207,770	207,770
Committed - 2012 Bicentennial celebration	3,471	-	3,471
Assigned - Debt service	1,416	-	1,416
Unassigned	2,371,285	-	2,371,285
TOTAL FUND BALANCE	2,408,669	207,770	2,616,439
TOTAL LIABILITIES AND FUND BALANCES	\$ 2,819,058	\$ 227,562	\$ 3,046,620

The accompanying notes are an integral part of these financial statements.

CITY OF FROSTBURG, MARYLAND

RECONCILIATION OF THE GOVERNMENTAL FUND BALANCE SHEET
TO THE STATEMENT OF NET ASSETS
JUNE 30, 2011

Total Fund Balances - Governmental Funds		\$ 2,616,439
Amounts reported for governmental activities in the statement of net assets are different because:		
Capital assets used in governmental activities are not financial resources and therefore are not reported in the governmental funds.		
Governmental capital assets, net of accumulated depreciation		9,033,295
Accounts receivable from taxes not collected within 60 days of year end are reported as deferred revenue in the governmental funds.		
Deferred revenue from taxes receivable		104,909
Loan costs incurred during refinancing are expensed when paid in the governmental fund statements but are amortized on the government-wide statements		
Bond & loan costs, net of accumulated amortization		15,750
Notes receivable do not provide current resources and are not reported in the governmental funds.		175,373
Accrued interest is recorded on fund statements only when due.		(29,393)
Long-term liabilities are not due and payable in the current period, and therefore are not reported as liabilities in the funds.		
Long-term debt	(1,105,000)	
Current portion of long-term debt	(55,000)	
Accrued post employment health insurance	(24,947)	
Compensated absences	(307,609)	
		(1,492,556)
TOTAL NET ASSETS - GOVERNMENTAL ACTIVITIES		<u>\$ 10,423,817</u>

The accompanying notes are an integral part of these financial statements.

CITY OF FROSTBURG, MARYLAND

**STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
FOR THE YEAR ENDED JUNE 30, 2011**

	<u>General Fund</u>	<u>Special Revenue</u>	<u>Total Governmental Funds</u>
REVENUES			
Taxes			
Net property tax revenue	\$ 2,097,336	\$ -	\$ 2,097,336
Income taxes	447,969	-	447,969
Hotel motel tax	140,747	-	140,747
Highway use tax	33,954	-	33,954
Other taxes	179,122	-	179,122
Police protection grant	86,306	-	86,306
Public safety revenue	43,297	-	43,297
Licenses and permits	39,350	-	39,350
COPS grants	5,406	-	5,406
Rental program revenue	72,962	-	72,962
Recreational activities	74,535	-	74,535
Grant income - other	197,496	124,426	321,922
Other income	69,024	56,808	125,832
Interest	3,520	3,898	7,418
	<hr/>	<hr/>	<hr/>
TOTAL REVENUES	3,491,024	185,132	3,676,156
	<hr/>	<hr/>	<hr/>
EXPENDITURES			
Administration	862,356	20,190	882,546
Public safety	1,441,050	-	1,441,050
Street department	712,816	-	712,816
Recreation department	419,342	-	419,342
Debt service	65,000	-	65,000
Capital outlays	338,095	142,994	481,089
	<hr/>	<hr/>	<hr/>
TOTAL EXPENDITURES	3,838,659	163,184	4,001,843
	<hr/>	<hr/>	<hr/>
EXCESS(DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES	(347,635)	21,948	(325,687)
	<hr/>	<hr/>	<hr/>
OTHER FINANCING SOURCES (USES)			
Interfund transfers	302,152	-	302,152
Note proceeds	-	20,000	20,000
Proceeds from sale of capital assets	13,000	-	13,000
Rental income	84,103	-	84,103
	<hr/>	<hr/>	<hr/>
TOTAL OTHER FINANCING SOURCES (USES)	399,255	20,000	419,255
	<hr/>	<hr/>	<hr/>
NET CHANGE IN FUND BALANCES	51,620	41,948	93,568
	<hr/>	<hr/>	<hr/>
FUND BALANCE - JULY 1, 2010	2,357,049	165,822	2,522,871
	<hr/>	<hr/>	<hr/>
FUND BALANCE - JUNE 30, 2011	\$ 2,408,669	\$ 207,770	\$ 2,616,439
	<hr/>	<hr/>	<hr/>

The accompanying notes are an integral part of these financial statements.

CITY OF FROSTBURG, MARYLAND

RECONCILIATION OF THE GOVERNMENTAL FUND
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE
TO THE STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2011

Total Net Change in Fund Balance - Governmental Funds \$ 93,568

Amounts reported for governmental activities in the statement
of activities are different because:

Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is depreciated over their estimated useful lives.

Expenditures for capital assets	338,095	
Less current year depreciation	(351,414)	(13,319)

Governmental funds report the proceeds from the sale of capital assets as income; however, in the statement of activities the sale of capital assets are reported net of the remaining book value of the assets as either gain or loss

Net book value of disposed capital assets in the statement of activities	(3,800)
--	---------

Governmental funds report bond & loan costs as expenditures. However, in the statement of activities, these costs are amortized over the life of the bond

Current year amortization	(2,100)
---------------------------	---------

Repayment of note proceeds is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets.

65,000

Proceeds from notes are reported as other financing sources in the governmental funds, but they are recorded as long-term liabilities in the statement of assets.

(20,000)

Governmental funds do not report donations of capital. However, in the statement of activities, the fair market value of the donated assets are reported as Capital Contributions

80,885

Governmental funds report notes issued to citizens for capital improvements as expenditures and the subsequent repayments of these notes as income; however, these transactions are not reported in the statement of activities.

Issuance of notes receivable	143,960	
Proceeds from notes receivable	(38,308)	105,652

Some revenues reported in the statement of activities do not provide current financial resources and, therefore, are not reported as revenues in governmental funds.

Change in deferred revenues	15,782
-----------------------------	--------

Some expenses reported in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in the governmental funds.

Change in accrued interest	1,667
Change in accrued post employment health insurance	(12,473)
Change in compensated absences	28,776

TOTAL CHANGE IN NET ASSETS OF GOVERNMENTAL ACTIVITIES

\$ 339,638

The accompanying notes are an integral part of these financial statements.

CITY OF FROSTBURG, MARYLAND

STATEMENT OF NET ASSETS
PROPRIETARY FUNDS
JUNE 30, 2011

	Water	Sewer	Water Surcharge	Garbage	Total
ASSETS					
Current Assets:					
Cash and cash equivalents	\$ 460,014	\$ -	\$ 702,678	\$ 86,165	\$ 1,248,857
Accounts receivable	172,968	559,021	580,085	104,560	1,416,634
Prepaid expenses	4,077	4,522	-	3,067	11,666
Due from other proprietary funds	150,000	-	-	-	150,000
Total Current Assets	787,059	563,543	1,282,763	193,792	2,827,157
Capital Assets					
Non-depreciable	14,055	380,976	227,610	-	622,641
Depreciable, net of accumulated depreciation	1,324,412	9,543,603	14,542,657	93,586	25,504,258
Total Capital Assets, net of accumulated depreciation	1,338,467	9,924,579	14,770,267	93,586	26,126,899
Non-current Assets					
Bond & loan costs, net of accumulated amortization	-	-	137,110	-	137,110
TOTAL ASSETS	\$ 2,125,526	\$ 10,488,122	\$ 16,190,140	\$ 287,378	\$ 29,091,166
LIABILITIES AND NET ASSETS					
Current Liabilities:					
Accounts payable and accrued expenses	\$ 78,049	\$ 453,604	\$ 587,093	\$ 14,827	\$ 1,133,573
Salaries and benefits payable	8,038	6,841	-	4,460	19,339
Sanitary Commission payable	-	70,000	-	-	70,000
Due to other funds	329,435	352,338	-	1,565	683,338
Due to other proprietary funds	-	-	150,000	-	150,000
Current portion of long-term debt	-	15,394	470,600	23,002	508,996
Total Current Liabilities	415,522	898,177	1,207,693	43,854	2,565,246
Noncurrent Liabilities					
Compensated absences	76,225	37,084	-	33,203	146,512
Accrued post employment health insurance	3,088	3,701	-	2,158	8,947
Notes payable, less current portion	-	137,809	8,273,400	34,861	8,446,070
Total Noncurrent Liabilities	79,313	178,594	8,273,400	70,222	8,601,529
TOTAL LIABILITIES	494,835	1,076,771	9,481,093	114,076	11,166,775
Net Assets					
Invested in capital assets, net of related debt	1,338,467	9,771,376	6,026,267	35,723	17,171,833
Unrestricted - undesignated	292,224	(360,025)	682,780	137,579	752,558
Total Net Assets	1,630,691	9,411,351	6,709,047	173,302	17,924,391
TOTAL LIABILITIES AND NET ASSETS	\$ 2,125,526	\$ 10,488,122	\$ 16,190,140	\$ 287,378	\$ 29,091,166

The accompanying notes are an integral part of these financial statements.

CITY OF FROSTBURG, MARYLAND

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
PROPRIETARY FUNDS
FOR THE YEAR ENDED JUNE 30, 2011

	Water	Sewer	Water Surcharge (Restricted)	Garbage	Total
OPERATING REVENUES	<u>\$ 1,139,769</u>	<u>\$ 1,498,937</u>	<u>\$ 871,765</u>	<u>\$ 387,959</u>	<u>\$ 3,898,430</u>
OPERATING EXPENSES					
Depreciation and amortization	109,880	378,560	767,036	13,467	1,268,943
Sewer operating	-	879,559	-	-	879,559
Salaries and wages	222,902	154,828	-	121,753	499,483
Filtration contract payments	395,915	-	-	-	395,915
Employee benefits	73,709	63,045	-	59,649	196,403
Landfill charges	-	-	-	97,330	97,330
Pumping system	104,859	-	-	-	104,859
Other	120,775	10,400	1,643	23,465	156,283
Distribution	53,755	-	-	-	53,755
Meters expense	65,049	-	-	-	65,049
Sanitation operating	-	-	-	9,034	9,034
Payroll taxes	15,927	10,913	-	8,789	35,629
Purification	2,513	-	-	-	2,513
Total Operating Expenses	<u>1,165,284</u>	<u>1,497,305</u>	<u>768,679</u>	<u>333,487</u>	<u>3,764,755</u>
Operating Income (Loss)	<u>(25,515)</u>	<u>1,632</u>	<u>103,086</u>	<u>54,472</u>	<u>133,675</u>
NON-OPERATING REVENUE (EXPENSES)					
Project reimbursements	295,009	829,919	663,527	-	1,788,455
Timber Sales	117,500	-	-	-	117,500
Interest revenue	425	-	473	127	1,025
Loss on disposal of assets	(10,410)	-	-	-	(10,410)
Interest expense	-	(5,011)	(352,321)	(3,780)	(361,112)
Total Non-operating Revenues (Expenses)	<u>402,524</u>	<u>824,908</u>	<u>311,679</u>	<u>(3,653)</u>	<u>1,535,458</u>
Income Before Transfers	<u>377,009</u>	<u>826,540</u>	<u>414,765</u>	<u>50,819</u>	<u>1,669,133</u>
Transfers out	<u>(159,752)</u>	<u>(125,100)</u>	<u>-</u>	<u>(17,300)</u>	<u>(302,152)</u>
Change in Net Assets	<u>217,257</u>	<u>701,440</u>	<u>414,765</u>	<u>33,519</u>	<u>1,366,981</u>
TOTAL NET ASSETS - JULY 1, 2010	<u>1,413,434</u>	<u>8,709,911</u>	<u>6,294,282</u>	<u>139,783</u>	<u>16,557,410</u>
TOTAL NET ASSETS - JUNE 30, 2011	<u>\$ 1,630,691</u>	<u>\$ 9,411,351</u>	<u>\$ 6,709,047</u>	<u>\$ 173,302</u>	<u>\$ 17,924,391</u>

The accompanying notes are an integral part of these financial statements.

CITY OF FROSTBURG
STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS
FOR THE YEAR ENDED JUNE 30, 2011

	Water	Sewer	Water Surcharge	Garbage	Total
CASH FLOWS FROM OPERATING ACTIVITIES:					
Receipts from customers and users	\$ 1,135,813	\$ 1,524,267	\$ 872,555	\$ 381,018	\$ 3,913,653
Payments to vendors	(809,979)	(1,106,812)	(1,957)	(203,159)	(2,121,907)
Payments to employees	(215,910)	(147,498)	-	(118,688)	(482,096)
Net Cash Provided By Operating Activities	109,924	269,957	870,598	59,171	1,309,650
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:					
Transfers out	(159,752)	(125,100)	-	(17,300)	(302,152)
Change in due to/from other funds	180	154,101	-	49	154,330
Net Cash Provided By (Used In) Noncapital Financing Activities	(159,572)	29,001	-	(17,251)	(147,822)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:					
Purchase of capital assets	(57,413)	(1,080,697)	(716,423)	-	(1,854,533)
Principal paid on loans	-	(15,015)	(342,600)	(21,752)	(379,367)
Proceeds from loan refinancing	-	-	118,500	-	118,500
Proceeds from sale of capital assets	700	-	-	-	700
Project reimbursements	-	801,921	251,984	-	1,053,905
Timber sales	117,500	-	-	-	117,500
Interest paid on loans	-	(5,167)	(359,665)	(3,887)	(368,719)
Net Cash Used In Capital and Related Financing Activities	60,787	(298,958)	(1,048,204)	(25,639)	(1,312,014)
CASH FLOWS FROM INVESTING ACTIVITIES					
Interest earned	425	-	473	127	1,025
Net change in Cash	11,564	-	(177,133)	16,408	(149,161)
Cash and cash equivalents, beginning of year	448,450	-	879,811	69,757	1,398,018
Cash and cash equivalents, end of year	\$ 460,014	\$ -	\$ 702,678	\$ 86,165	\$ 1,248,857
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES					
Operating Income (Loss)	\$ (25,515)	\$ 1,632	\$ 103,086	\$ 54,472	\$ 133,675
Adjustments Not Affecting Cash					
Depreciation	109,880	378,560	672,038	13,467	1,173,945
Amortization	-	-	94,998	-	94,998
(Increase) decrease in accounts receivable	(3,956)	25,330	790	(6,941)	15,223
(Increase) decrease in prepaid expenses	(2,036)	(2,816)	-	(2,081)	(6,933)
Increase (decrease) in accounts payable and accrued expenses	23,015	(141,929)	(314)	(3,890)	(123,118)
Increase (decrease) in salaries and benefits payable	841	2,197	-	331	3,369
Increase (decrease) in deposits	-	-	-	-	-
Increase (decrease) in accrued hospital insurance	1,544	1,850	-	1,079	4,473
Increase (decrease) in compensated absences	6,151	5,133	-	2,734	14,018
Total Adjustments	135,439	268,325	767,512	4,699	1,175,975
Net Cash Provided By Operating Activities	\$ 109,924	\$ 269,957	\$ 870,598	\$ 59,171	\$ 1,309,650
Noncash Transactions					
Land Improvements at Savage River headwater dam and stream performed by Savage River Watershed Association	\$ 295,009	\$ -	\$ -	\$ -	\$ -

The accompanying notes are an integral part of these financial statements.

CITY OF FROSTBURG, MARYLAND
NOTES TO THE FINANCIAL STATEMENTS

NOTE 1 REPORTING ENTITY

The City of Frostburg, Maryland (the "City") was incorporated in 1870 and adopted its first Charter in 1885. The City operates under a Council-Administrator form of government per Charter Revision Resolution No. 23 adopted July 1, 1981. The City of Frostburg adopted Charter Revision Resolution No. 2001-17 on December 21, 2001, effective February 2, 2002 which repealed the 1981 edition and also provides the following services as authorized by its Charter: public safety (police and fire), public works (maintenance, sewer, streets, and water), recreation, community development and general administrative services.

In evaluating how to define the City of Frostburg, Maryland, for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the criteria set forth in generally accepted accounting principles (GAAP). The basic, but not the only, criterion for including a potential component unit within the reporting entity is the governing body's ability to exercise oversight responsibility. The most significant manifestation of this ability is financial interdependency. Other manifestations of the ability to exercise oversight responsibility include, but are not limited to, the selection of governing authority, the designation of management, and the ability to significantly influence operations and accountability for fiscal matters. The other criterion used to evaluate potential component units for inclusion or exclusion from the reporting entity is the existence of special financing relationships, regardless of whether the City is able to exercise oversight responsibilities. Based upon the application of these criteria, no potential component units were identified for inclusion in the reporting entity.

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the City have been prepared in conformity with GAAP as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the government's accounting policies are described below.

A. Basis of Presentation

The City's basic financial statements consist of government-wide statements, including a statement of net assets and a statement of activities, and fund financial statements which provide a more detailed level of financial information.

Government-Wide Financial Statements The statement of net assets and the statement of activities display information about the City as a whole. These statements include the financial activities of the primary government. The statements distinguish between those activities of the City that are governmental (primarily supported by taxes, County appropriations and intergovernmental revenues) and those that are considered business-type activities (primarily supported by fees and charges).

The statement of net assets presents the financial condition of the governmental and business-type activities of the City at year-end. The statement of activities presents a comparison between direct

CITY OF FROSTBURG, MARYLAND

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2 **SIGNIFICANT ACCOUNTING POLICIES** - Continued

expenses and program revenues for each program or function of the City's governmental activities and for the business-type activities of the City. Direct expenses are those that are specifically associated with a service, program or department and therefore clearly identifiable to a particular function. Program revenues include charges paid by the recipient of the goods or services offered by the program, grants and contributions that are restricted to meeting the operational or capital requirements of a particular program and interest earned on grants that is required to be used to support a particular program. Revenues which are not classified as program revenues are presented as general revenues of the City. The comparison of direct expenses with program revenues identifies the extent to which each business segment or governmental function is self-financing or draws from the general revenues of the City.

As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements.

Fund Financial Statements During the year, the City segregates transactions related to certain City functions or activities in separate funds in order to aid financial management and to demonstrate legal compliance. Fund financial statements are designed to present financial information of the City at this more detailed level. The focus of governmental and enterprise fund financial statements is on major funds. Each enterprise and governmental fund was a major fund and is presented in a separate column.

B. Fund Accounting

The accounts of the City are organized on the basis of funds that is each considered to be a separate accounting entity. The operations of each fund are summarized by providing a separate set of self-balancing accounts which include its assets, liabilities, fund equity, revenues and expenses or expenditures. The following funds are used by the City:

Governmental Fund Types

General Fund

The General Fund is the general operating fund of the City. All financial resources, except those required to be accounted for in another fund, are accounted for in this fund.

Special Revenue Funds

The Community Block Grant Fund is a special revenue fund used to account for the revenue from Community Development Block Grants received by the City of Frostburg. In the event an expenditure is incurred for purposes for which both restricted and unrestricted net assets are available, restricted resources are used first.

Proprietary Fund Type

Water, Sewer, Water Surcharge, and Garbage Funds

The Water, Sewer, Water Surcharge, and Garbage Funds are enterprise funds used to account for the operations which are financed and operated in a manner similar to private businesses. The intent is that the cost of providing the services to the public is to be financed or recovered primarily through user charges.

CITY OF FROSTBURG, MARYLAND

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES – Continued

C. Measurement Focus

Government-wide Financial Statements The government-wide financial statements are prepared using the economic resources measurement focus. All assets and all liabilities associated with the operation of the City are included on the statement of net assets. The statement of activities presents increases (i.e. revenues) and decreases (i.e. expenses) in total net assets.

Fund Financial Statements All governmental funds are accounted for using a flow of current financial resources measurement focus. With this measurement focus, only current assets and current liabilities generally are included on the balance sheet. The statement of revenues, expenditures and changes in fund balances reports on the sources (e.g., revenues and other financing sources) and uses (e.g., expenditures and other financing uses) of current financial resources. This approach differs from the manner in which the governmental activities of the government-wide financial statements are prepared. Governmental fund financial statements therefore include reconciliation with brief explanations to better identify the relationship between the government-wide statements and the statements for governmental funds.

Like the government-wide statements, the enterprise fund is accounted for on a flow of economic resources measurement focus. All assets and all liabilities associated with the operation of this fund are included on the statement of net assets. The statement of changes in fund net assets presents increases (e.g., revenues) and decreases (e.g., expenses) in net total assets. The statement of cash flows provides information about how the City finances and meets the cash flow needs of its enterprise funds.

D. Basis of Accounting

Basis of accounting determines when transactions are recorded in the financial records and reported on the financial statements. Government-wide financial statements are prepared using the accrual basis of accounting. Governmental funds use the modified accrual basis of accounting. Proprietary funds also use the accrual basis of accounting. Differences in the accrual and modified accrual basis of accounting arise in the recognition of revenue, the recording of deferred revenue and in the presentation of expenses versus expenditures.

The modified accrual basis of accounting is used by all governmental fund types. Under the modified accrual basis of accounting, revenues are recognized when susceptible to accrual (i.e., when they become both measurable and available). "Measurable" means the amount of the transaction can be determined and "available" means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period. The City considers property taxes as available if they are collected within 60 days after year-end. Penalties and interest and miscellaneous revenues are recorded when received in cash since they are generally not measurable until actually collected. Expenditures are recorded when the related fund liability is incurred.

The proprietary funds are accounted for on a flow of economic resources measurement focus. The accrual basis of accounting is utilized by the proprietary fund types. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. All GASB

CITY OF FROSTBURG, MARYLAND

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES - Continued

pronouncements are followed in the proprietary funds. FASB, APB Opinions and ARB's issued before November 30, 1989 are followed to the extent they do not contradict GASB. FASB pronouncements issued after November 30, 1989 that are developed for business entities are followed to the extent that they do not contradict GASB.

The City reports deferred revenue on its combined balance sheet. Deferred revenues arise when potential revenue does not meet both the "measurable" and "available" criteria for recognition in the current period. Deferred revenues also arise when resources are received by the City before it has a legal claim to them, as when grant monies are received prior to the incurring of qualifying expenditures. In subsequent periods, where both revenue recognition criteria are met or when the City has a legal claim to the resources, the liability for deferred revenue is removed from the combined balance sheet and revenue is recognized.

E. Budgets and Budgetary Accounting

Formal budgetary accounting, as set forth in the City Charter, is employed as a management control for the General Fund and the Water, Sewer, Water Surcharge, and Garbage Enterprise Funds. Annual operating budgets are adopted by the City each fiscal year through passage of an annual budget and amended as required for all funds. Budget amendments requiring a change between categories requires approval by the Mayor and City Council. A budget reconciliation has been provided to reflect the differences between budgetary inflows and outflows and GAAP revenues and expenses/expenditures. Budgets presented in the financial statements reflect all amendments.

The budget for the Enterprise Funds is adopted under the GAAP basis of accounting except that depreciation is not considered and fixed assets additions are treated as an expense. The City does not budget for the Special Revenue Fund since budgetary control is maintained on an individual grant basis.

F. Cash and Equivalents

For financial statement purposes, the City considers all short-term, highly liquid investments with an original maturity of three months or less to be cash and cash equivalents.

G. Capital Assets

General capital assets are those assets not specifically related to activities reported in the proprietary funds. These assets generally result from expenditures in the governmental funds.

These assets are reported in the governmental activities column of the government-wide statement of net assets but are not reported in the fund financial statements. Capital assets utilized by the enterprise funds are reported both in the business-type activities column of the government-wide statement of net assets and in the funds.

All capital assets are capitalized at cost (or estimated historical cost). When a capital asset is disposed or retired, the cost and related accumulated depreciation is removed from the books with any gain or loss reflected as income. The City maintains a capitalization threshold of \$5,000. Public domain ("infrastructure") general fixed assets including roads, bridges, curbs and gutters,

CITY OF FROSTBURG, MARYLAND

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES - Continued

streets and sidewalks, drainage systems, and lighting systems are capitalized along with other general fixed assets. Improvements are capitalized; the costs of normal maintenance and repairs that do not add to the value of the asset or materially extend an asset's life are not.

All reported capital assets except land are depreciated. Improvements are depreciated over the remaining useful lives of the related capital assets. Depreciation is computed using the straight-line method over the following useful lives.

Land improvements	10-20 years
Building and improvements	25-40 years
Machinery and equipment	5-10 years
Infrastructure and utility systems	20-40 years

In the Water Fund, depreciation is recorded at a rate of 2.2% of the current year acquisitions and 3.33% of the prior years fixed asset balance for infrastructure. Machinery and equipment is depreciated as per the schedule above. Depreciation was recorded at the rate of 2.5% of the EDA water improvements and the Piney Dam construction projects.

H. Capitalized Interest

Interest costs incurred by proprietary funds on debt where the proceeds were used to finance the construction of assets are capitalized.

I. Compensated Absences

The City has implemented the provisions of the Governmental Accounting Standards Board's Accounting for Compensated Absences. This statement requires the recording of accumulated unused sick leave, compensatory time, and vacation leave if such amounts will be paid as termination benefits. The liability is calculated by taking the total hours of time outstanding at June 30, times the current rate of pay for each employee. One paid sick day is accrued for each month of service after the probationary period. Upon termination of employment, the accumulated sick leave is lost. Upon reaching the age of 60 and retirement, the employee is paid for up to 90 days of unused sick leave at the employee's current rate of pay.

At June 30, 2011, no liability has been recorded for the current portion of compensated absences as the City feels that absences used during the next year will not materially exceed the absences earned during the next year. Therefore, all compensated absences are recorded as long-term. The long-term portion of this liability of \$454,121 has been recorded in the government-wide statement of net assets, of which \$146,512 is from business-type activities. This represents a decrease of \$14,758 from the prior year total of \$468,879. The change in compensated absences for business-type activities was an increase of \$14,018.

J. Interfund Activity

Transfers between governmental and business-type activities on the government-wide statements are reported in the same manner as general revenues.

CITY OF FROSTBURG, MARYLAND

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES - Continued

Exchange transactions between funds are reported as revenues in the seller funds and as expenditures/expenses in the purchaser funds. Flows of cash or goods from one fund to another without a requirement for repayment are reported as interfund transfers. Interfund transfers are reported as other financing sources/uses in governmental funds and after nonoperating revenues/expenses in proprietary funds. Repayments from funds responsible for particular expenditures/expenses to the funds that initially paid for them are not presented on the financial statements.

Interfund transfers for the year ended June 30, 2011 consisted of transfers of \$159,752 from the Water Fund, \$125,100 from the Sewer Fund, and \$17,300 from the Garbage Fund to the General Fund to help cover administrative overhead costs.

K. Interfund Balances

On fund financial statements, receivables and payables resulting from short-term interfund loans are classified as "interfund receivables/payables." These amounts are eliminated in the governmental and business-type activities columns of the statement of net assets, except for the net residual amounts due between governmental and business-type activities, which are presented as internal balances. Interfund balances have no set repayment schedule and are generally not expected to be repaid within one year.

The composition of interfund balances as of June 30, 2011 is as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General	Water	\$ 329,435
General	Sewer	352,338
General	Garbage	1,565
General	Special Rev	825
		<u>\$ 684,163</u>

L. Fund Balance

The City is required to report its fund balance within the following classifications on the governmental fund financial statements: nonspendable, restricted, committed, assigned, and unassigned. The City Council is the City's highest level of decision-making authority and a formal resolution by them at the City Council meeting is required to be taken to establish, modify, or rescind a fund balance commitment. The resolution must be approved or rescinded by them prior to the last day of the fiscal year for which the commitment is made. The amount subject to the restraint may be determined in the subsequent period. The City Council has authorized the City's Finance Director to assign fund balance amounts to a specific purpose as approved by the City's fund balance policy.

In the event the City incurs expenditures where restricted and unrestricted resources can be used, the City will use restricted resources first. In the event an expenditure is made from multiple unrestricted resources, the City's order of spending will be committed, assigned, and unassigned.

CITY OF FROSTBURG, MARYLAND

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES - Continued

M. Operating Revenues and Expenses

Operating revenues are those revenues that are generated directly from the primary activity of the proprietary funds. For the City, these revenues are for services primarily provided by the Water, Water Surcharge, Sewer, and Garbage Funds to the general public. Operating expenses are necessary costs incurred to provide the service that is the primary activity of the fund. Revenues and expenses not meeting this definition are reported as non-operating.

N. Property Taxes

Taxes are levied each July 1 on the assessed value listed as of the prior January 1 for all real property located within City boundaries which receive substantially all City services and payable without penalty until September 30. The City bills and collects its own property taxes. City property tax revenues are recognized when levied to the extent that they result in current receivables. Assessed values are established by the Maryland Department of Assessments and Taxation based on estimates of fair market value. A revaluation of all property is required to be completed every three years and any increase in assessed value is phased in over a three year period. For the year ended June 30, 2011, the City had a tax margin of \$.55 per \$100 assessed valuation.

O. Credit Risk

As of June 30, 2011, the City has recorded receivables from various entities and individuals. As these receivables are believed to be completely collectable, an allowance for doubtful accounts is not recorded. If an account is determined to be uncollectible, the direct write-off method is used. This does not produce a result materially different from the allowance method of accounting.

P. Estimates

The preparation of the financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from those estimates.

NOTE 3 CASH AND INVESTMENTS

The cash deposits of the City of Frostburg are governed by Maryland Article 95-22. The City may establish official depositories with any bank or savings and loan located in the state of Maryland. The City may also establish time deposits and certificates of deposit. As of June 30, 2011, the reconciled balances of the City's deposits were \$3,319,998 and the bank balances were \$3,414,287. Of the bank balances, \$1,868,301 was covered by federal depository insurance and \$1,545,986 was covered by collateral held by the financial institutions in the City's name.

The investment policy of the City is to invest public funds in a manner which will provide the highest investment return with the maximum security while meeting the daily cash flow demands of the City and conforming to all state and local statutes governing the investment of public funds.

CITY OF FROSTBURG, MARYLAND
NOTES TO THE FINANCIAL STATEMENTS

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NOTE 3 CASH AND INVESTMENTS - Continued

The primary objectives, in priority order, of the City's investment activities shall be safety, liquidity, and return on investment.

At June 30, 2011, the City had a certificate of deposit in the amount of \$94,437 held at a local financial institution which is included in the City's deposit figure of \$3,319,998. The certificate of deposit is set to mature in April 2013.

Interest Rate Risk – In accordance with its investment policy, the City manages its exposure to declines in fair values arising from interest rates by limiting the maturity date of securities to no more than one year from the date of purchase, unless it is matched to a specific cash flow requirement.

Credit Risk – The City's investment policy limits the investments of the portfolio to 5% commercial paper, 50% money market mutual funds, 40% bankers' acceptance, 40% collateralized certificates of deposit, 90% repurchase agreements, and 90% U.S. government agency and U.S. government sponsored instruments.

Custodial Credit Risk – Deposits and investments are exposed to custodial credit risk if they are not covered by depository insurance and the deposits are uncollateralized, collateralized with securities held by the pledging financial institution, or collateralized with securities held by the pledging financial institution's trust department or agent but not in the depositor-city's name. All of the City's deposits are covered by depository insurance and are collateralized with securities held by the financial institution in the City's name, therefore mitigating custodial credit risk.

NOTE 4 ACCOUNTS RECEIVABLE

The City's accounts receivable as of June 30, 2011 consisted of the following:

	Governmental	Water	Sewer	Water Surcharge	Garbage	Total
Taxes	\$ 113,523	\$	\$	\$	\$	\$ 113,523
Intergovernmental	122,016		270,503	411,543		804,062
Charge for services		171,296	256,922	167,807	103,910	699,935
Interest		250	873	735	650	2,508
Other	23,280	1,422	30,723			55,425
Total	\$ 258,819	\$ 172,968	\$ 559,021	\$ 580,085	\$ 104,560	\$ 1,675,453

At the end of the current fiscal year, deferred revenue of \$104,909 was recognized due to unavailability in the governmental fund statements.

CITY OF FROSTBURG, MARYLAND
NOTES TO THE FINANCIAL STATEMENTS

NOTE 5 CAPITAL ASSETS

Depreciation expense for governmental capital assets was charged to the following accounts as follows for the year ended June 30, 2011:

General Government	\$	47,638
Public Safety		28,517
Public Works		176,482
Recreation and Parks		98,777
Total	\$	<u>351,414</u>

(Note 5 continues on page 34.)

CITY OF FROSTBURG, MARYLAND

NOTES TO THE FINANCIAL STATEMENTS

NOTE 5 CAPITAL ASSETS - Continued

The following is a summary of the changes in the fixed asset accounts for the year ended June 30, 2011:

	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Governmental Activities					
Non-depreciable Assets					
Land	\$ 2,033,368	\$ 49,834	\$ -	\$ -	\$ 2,083,202
Construction-in-progress	11,855	75,545			87,400
Total Non-depreciable Assets	2,045,223	125,379	-	-	2,170,602
Depreciable Assets					
Land Improvements	879,006	-	-	-	879,006
Buildings and Improvements	3,440,676	36,718			3,477,394
Infrastructure	5,416,814	196,212			5,613,026
Machinery & equipment	1,331,253	60,671	(53,000)		1,338,924
Total Depreciable Assets	11,067,749	293,601	(53,000)	-	11,308,350
Less, Accumulated Depreciation for:					
Land Improvements	340,141	44,744		-	384,885
Buildings and Improvements	1,558,412	84,489		-	1,642,901
Infrastructure	1,447,015	148,038		-	1,595,053
Machinery & equipment	797,875	74,143	(49,200)	-	822,818
Total Accumulated Depreciation	4,143,443	351,414	(49,200)	-	4,445,657
Depreciable Assets, net of accumulated depreciation	6,924,306	(57,813)	(3,800)	-	6,862,693
Total Governmental Capital Assets, net of accumulated depreciation	\$ 8,969,529	\$ 67,566	\$ (3,800)	\$ -	\$ 9,033,295
Business-type Activities					
Non-depreciable Assets					
Land	\$ 48,299	\$ -	\$ -	\$ -	\$ 48,299
Construction-in-progress	403,256	2,362,370		(2,191,284)	574,342
Total Non-depreciable Assets	451,555	2,362,370	-	(2,191,284)	622,641
Depreciable Assets					
Land Improvements	13,200,608	295,009			13,495,617
Buildings and Improvements	8,304,108				8,304,108
Infrastructure	14,854,568			2,191,284	17,045,852
Machinery & equipment	1,106,166	52,268	(19,200)		1,139,234
Total Depreciable Assets	37,465,450	347,277	(19,200)	2,191,284	39,984,811
Less, Accumulated Depreciation for:					
Land Improvements	6,087,155	338,609			6,425,764
Buildings and Improvements	3,655,151	269,827			3,924,978
Infrastructure	2,939,653	496,749			3,436,402
Machinery & equipment	632,741	68,759	(8,090)		693,410
Total Accumulated Depreciation	13,314,700	1,173,944	(8,090)	-	14,480,554
Depreciable Assets, net of accumulated depreciation	24,150,750	(826,667)	(11,110)	2,191,284	25,504,257
Total Business-type Capital Assets, net of accumulated depreciation	\$ 24,602,305	\$ 1,535,703	\$ (11,110)	\$ -	\$ 26,126,898

CITY OF FROSTBURG, MARYLAND
NOTES TO THE FINANCIAL STATEMENTS

NOTE 6 LONG TERM DEBT

The following is a summary of the changes in long-term debt for the year ended June 30, 2011:

	Outstanding 6/30/2010	Additions	Reductions	Outstanding 6/30/2011	Due Within One Year
Governmental Activities					
Bonds & Notes Payable					
Susquehanna Bank	\$ 170,000	\$ -	\$ (35,000)	\$ 135,000	\$ 25,000
Suntrust Bank – Pension Debt	1,035,000		(30,000)	1,005,000	30,000
Subtotal	1,205,000	-	(65,000)	1,140,000	55,000
Other Obligations					
Compensated Absences	336,385		(28,776)	307,609	-
Accrued post employment health insurance	12,473	12,474	-	24,947	-
Total Governmental Activity Long-term Obligations	<u>\$ 1,553,858</u>	<u>\$ 12,474</u>	<u>\$ (93,776)</u>	<u>\$ 1,472,556</u>	<u>\$ 55,000</u>
Business-type Activities					
Bonds & Notes Payable					
MDE - Emergency Sewer Project	\$ 168,218	\$ -	\$ (15,015)	\$ 153,203	\$ 15,394
CDA - Various Projects	3,711,600		(227,600)	3,484,000	235,600
M & T Bank - Garbage Truck	79,615		(21,752)	57,863	23,002
BB&T Bank – Piney Dam Project	5,169,000		(5,169,000)	-	-
BB&T Bank – Piney Dam Project		5,375,000	(115,000)	5,260,000	235,000
Subtotal	9,128,433	5,375,000	(5,548,367)	8,955,066	508,996
Other Obligations					
Compensated Absences	132,494	14,018	-	146,512	-
Accrued post employment health insurance	4,474	4,473	-	8,947	-
Total Business-type Activity Long-term Obligations	<u>\$ 9,265,401</u>	<u>\$ 5,393,491</u>	<u>\$ (5,548,367)</u>	<u>\$ 9,110,525</u>	<u>\$ 508,996</u>

The loan payable to SunTrust Bank refinanced the State Retirement and Pension System of Maryland debt and is payable in variable annual installments of principal and semi-annual installments of interest at 6.41% on the balance outstanding. The loan is uncollateralized and 18 installments of principal and interest and an additional 17 installments of interest only remain.

The bond payable to Susquehanna Bank is payable in variable annual installments of principal plus semi-annual installments for interest at 4.4% on the outstanding balance. The bond is uncollateralized and has 7 installments of principal and interest and an additional 7 installments of interest only remaining.

The loan payable to BB&T Bank refinanced the CDA bond was payable in variable annual installments of principal, beginning on May 1, 2011, and semi-annual installments of interest at 4.09% on the balance outstanding. The bond was uncollateralized. The bond was refinanced on April 28, 2011 with BB&T Bank. The new refinancing is payable in variable annual installments of principal, beginning on May 1, 2011, and semi-annual installments of interest at 3.32% on the outstanding balance. The bond is uncollateralized and has 17 installments of principal and interest and 17 installments of interest only remaining.

The bond payable to the Maryland Department of Environment is payable in variable annual installments of principal and issuance fees plus semi-annual installments for interest at 2.50% on the outstanding balance. The issuance fees paid annually are fixed in the amount of \$979. The bond has 9 installments of principal, interest, and issuance costs and an additional 9 installments of interest only remaining.

CITY OF FROSTBURG, MARYLAND

NOTES TO THE FINANCIAL STATEMENTS

NOTE 6 LONG TERM DEBT - Continued

The CDA bond payable for various projects is payable in variable annual installments of principal plus semi-annual installments for interest and issuance costs. Interest rates on the outstanding balance range from 2.00% to 4.50% and the issuance fees range from \$707 to \$806 per installment. The bond is insured and has 12 installments of principal, interest, and issuance costs and an additional 12 installments of interest and issuance costs only remaining.

The capital lease payable to M&T Bank is payable in 84 monthly installments of \$2,137 including interest at 5.572% on the outstanding balance. The lease has 29 monthly installments remaining and is collateralized by a garbage truck. The original cost of the vehicle was \$149,635 with a current book value of \$82,299. The related amortization of the truck is included in depreciation expense.

On May 15, 2009, the City received a \$100,000 loan from the Maryland Department of Housing and Community Development (a portion of which, up to \$80,000 may be forgiven) for the purpose of funding Community Legacy Rehabilitation Projects. The City feels it has completed all the requirements for the maximum amount to be forgiven. The remaining \$20,000 portion of the loan not subject to forgiveness carries a 0.0% interest rate and has a maturity date of December 31, 2014. The City has not discounted the loan for the below market interest rate being carried on the loan.

On May 14, 2010, the City received a loan from the United States Department of Agriculture in the amount of \$922,510 to be used for the water transmission hydro-electric project. The loan carries an interest rate of 2.5% and is to be paid back in 160 installments of principal and interest. The City has not withdrawn any funds from this loan as of June 30, 2011 but has incurred \$451,900 of eligible expenditures.

The annual requirements to amortize all general long-term debt, as of June 30, 2011, are as follows:

Fiscal Year	Governmental Activities		Business-type Activities		Total		
	Principal	Interest & Fees	Principal	Interest & Fees	Principal	Interest & Fees	Total
2012	55,000	69,399	508,996	323,497	563,996	392,896	956,892
2013	60,000	66,216	528,611	306,028	588,611	372,244	960,855
2014	60,000	62,872	533,549	287,782	593,549	350,654	944,203
2015	80,000	59,529	531,426	269,619	611,426	329,148	940,574
2016	70,000	56,026	556,959	250,979	626,959	307,005	933,964
2017-2021	245,000	230,020	3,072,725	937,119	3,317,725	1,167,139	4,484,864
2022-2026	335,000	137,657	2,442,800	357,240	2,777,800	494,897	3,272,697
2027-2031	255,000	25,154	780,000	39,010	1,035,000	64,164	1,099,164
2032-2036	-	-	-	-	-	-	-
	<u>\$ 1,160,000</u>	<u>\$ 706,873</u>	<u>\$ 8,955,066</u>	<u>\$ 2,771,274</u>	<u>\$ 10,115,066</u>	<u>\$ 3,478,147</u>	<u>\$ 13,593,213</u>

CITY OF FROSTBURG, MARYLAND

NOTES TO THE FINANCIAL STATEMENTS

NOTE 6 LONG TERM DEBT - Continued

The source of funds for debt retirement is as follows:

	<u>Debt Amount</u>
General revenue	\$ 1,160,000
Sewer charges	153,203
Water surcharges	8,744,000
Garbage charges	57,863
	<u>\$ 10,115,066</u>

All compensated absences in the governmental activities will be paid out of the general fund. All compensated absences in the proprietary funds will be paid out of the funds where the liability was incurred. The City feels employee absences for the next year will not exceed the leave accrued by the employees during the year, thus the entire balance of compensated absences is considered to be long-term.

The City incurred interest of \$71,779 in the General Fund, and \$361,112 in the Proprietary Funds for the year ended June 30, 2011.

NOTE 7 RESTRICTED ASSETS - WATER SURCHARGE FUND

The Water Surcharge Fund is a restricted fund to be used for the improvements, construction, debt service, and other capital projects of the Piney Dam and the Water Treatment Plant. Fund income is derived from a surcharge to water service customers.

NOTE 8 PENSION PLAN

On December 6, 1982 the City adopted a money purchase pension plan that covers substantially all of its employees. All contributions, through ICMA, are invested with the consent of the pension committee. Employees may make voluntary contributions up to 10% of their annual compensation. The City contributes 9% of total compensation for all employees who have at least one year of service, are twenty-one years of age, have at least 1,000 hours of service, and are not members of a union. Employees become fully vested after 5 years of service. For the year ended June 30, 2011, the city contributed \$4,470 to this plan for one city employee. Effective July 1, 2006, all eligible city employees entered into Maryland's State Retirement and Pension System (SRPS). In doing so the City no longer contributes to the ICMA plan for these employees.

SRPS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. Article 73B of the Annotated Code of the State of Maryland assigns the authority to establish and amend benefit provisions to the SRPS Board of Trustees. The State of Maryland issues a publicly available financial report that includes financial statements and required supplementary information for SRPS. That report may be obtained by writing to Maryland State Retirement and Pension System, 301 West Preston Street, Baltimore, Maryland 21202.

CITY OF FROSTBURG, MARYLAND

NOTES TO THE FINANCIAL STATEMENTS

NOTE 8 **PENSION PLAN** - Continued

Members of the contributory pension systems are required to make contributions of 2% of earnable compensation. The City is required to contribute annually at an actuarially determined rate. The contribution rate for fiscal year 2011 was 9.72%, 6.47% for fiscal year 2010, and 6.26% for fiscal year 2009. The contribution requirements of plan members and the City are established and may be amended by the SRPS Board of Trustees. The City contribution to SRPS was \$152,102 for the year ended June 30, 2011, \$100,723 for the year ended June 30, 2010, and \$93,568 for the year ended June 30, 2009. The City contribution was equal to the required contribution for the year.

NOTE 9 **POSTEMPLOYMENT HEALTHCARE PLAN**

Plan Description – The City sponsors a single-employer post-retirement medical plan. The plan provides medical and prescription benefits to eligible retirees and their spouses. Coverage is available for employees who retire at age 60 until they are eligible for Medicare benefits. The contribution requirements of plan members and the City are established and may be amended by the Mayor and City Council. Plan members contribute 20% of the premium for medical and prescription benefits and the City contributes 80% of the premium until such time as the member qualifies for Medicare benefits. Once a member or spouse qualifies for Medicare benefits, the medical and prescription benefit through the City expires.

The Mayor and City Council adopted Resolution 2010-17 on May 20, 2010 which expanded the post employment benefits to include health insurance for employees who retire on Accidental Disability with the State Pension System between the age of 58 and ½ and age 60. This change was not included in the actuarial calculation of the City's post-retirement benefit as of June 30, 2011 and the effect of the policy change on the calculation is not known.

Funding Policy – The City is currently reviewing its options with respect to pre-funding these liabilities beyond its annual pay-go requirements.

Annual OPEB Cost and Net OPEB Obligation – The City's annual other post-retirement benefit (OPEB) cost (expense) is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years. The following table shows the components of the City's annual OPEB cost for the year, the amount actually contributed to the plan, and changes in the City's net OPEB obligation.

CITY OF FROSTBURG, MARYLAND

NOTES TO THE FINANCIAL STATEMENTS

NOTE 9 POSTEMPLOYMENT HEALTHCARE PLAN - Continued

Annual Required Contribution	\$ 18,446
Interest on Net OPEB Obligation	-
Adjustment to Annual Required Contribution	-
Annual OPEB Cost (Expense)	\$ 18,446
Contributions Made	1,499
Increase in Net Obligation	\$ 16,947
Net OPEB Obligation (Beginning of year)	\$ 16,947
Net OPEB Obligation (End of year)	\$ 33,894

The City's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation is as follows:

Fiscal Year Ended	Annual OPEB Cost	Percentage of OPEB Cost Contributed	Net OPEB Obligation
6/30/2011	18,446	8.1%	16,947
6/30/2010	18,446	8.1%	16,947

Funded Status and Funding Progress – As of July 1, 2009, the most recent actuarial valuation date, the plan was 0% funded. The actuarial accrued liability for benefits was \$138,183. The covered payroll (annual payroll of active employees covered by the plan) was \$1,644,898 and the ratio of the UAAL to the covered payroll was 8.4%.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Actuarial Methods and Assumptions – Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and includes the type of benefits provided at the time of each valuation and the historical pattern of sharing the benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

CITY OF FROSTBURG, MARYLAND

NOTES TO THE FINANCIAL STATEMENTS

NOTE 9 **POSTEMPLOYMENT HEALTHCARE PLAN** - Continued

In the July 1, 2009 actuarial valuation, the projected unit credit actuarial cost method was used. The actuarial assumptions included a 7.50% investment rate of return (net of administrative expenses), which is a blended rate of the expected long-term investment returns on plan assets and on the employer's own investments calculated based on the funded level of the plan assets at the valuation date, and an initial annual healthcare cost trend rate of 8.00%. The actuarial value of assets was determined using a standard balanced portfolio expectation for retirement plan assets returns. The UAAL is being amortized as a level percentage of payroll on an open basis. The remaining amortization period at July 1, 2009 was 30 years.

NOTE 10 **COMMUNITY DEVELOPMENT BLOCK GRANT FUND - INDIRECT COSTS**

The City does not charge indirect costs against Community Development Block Grant Funds, and accordingly, no Statement of Indirect Costs has been prepared.

NOTE 11 **OPERATING LEASE**

The City leases the Armory building to the State of Maryland. The City renewed the lease effective November 1, 2007 through 2012 with a monthly lease payment of \$7,009. The minimum lease payment for this five year period is expected to be \$84,103 per year. The City's cost of the building was \$595,913 and the related accumulated depreciation through June 30, 2011 was \$593,716.

The City entered into a lease agreement with the Allegany County Human Resources Development Commission for the front section of the Community Center building on Water Street. The lease is effective October 1, 2010 through September 30, 2015 with a monthly lease payment of \$649 for the first year. The minimum lease payment for the five year period is expected to be \$7,791 payable per year. The lease contains an annual escalator clause of 3% per year for the remainder of the agreement. The City's cost of the building was \$541,722 and the related accumulated depreciation through June 30, 2011 was \$170,237

. Future minimum yearly lease payments are expected to be as follows:

2012	\$ 92,074
2013	36,241
2014	8,451
2015	8,705
2016	2,196
Total	<u>\$ 147,667</u>

On November 28, 2008, the City entered into an operating lease with Queen City Business Systems for a copy machine. The lease requires 60 monthly payments of \$200 per month and is set to expire on November 28, 2013.

On September 19, 2008, the City entered into an operating lease with Pitney Bowes for a postage machine. The lease requires 60 monthly payments of \$195 per month and is set to expire September 19, 2013.

CITY OF FROSTBURG, MARYLAND

NOTES TO THE FINANCIAL STATEMENTS

NOTE 11 OPERATING LEASE - Continued

On March 23, 2011, the City entered into an operating lease with Queen City Business Systems for a copy machine. The lease requires 60 monthly payments of \$194 per month and is set to expire on March 23, 2016.

Future minimum yearly lease payments are expected to be as follows:

2012	\$	7,068
2013		7,068
2014		3,913
2015		2,328
2016		1,746
Total		<u>\$20,377</u>

Rental income for the Armory building totaled \$91,831 for the year ended June 30, 2011. Rent expense for the copy machines and postage machine totaled \$5,322 for the year ended June 30, 2011.

NOTE 12 RISK OF LOSS

The City utilizes commercial insurance for employee life, health, disability, and workers' compensation as well as its property and liability insurance. The City retains the risk of loss for Maryland Unemployment Compensation. The City feels that the commercial insurance provides adequate coverage and that the potential loss from Maryland Unemployment Compensation is immaterial to the City's overall financial position.

NOTE 13 INSURANCE RECOVERIES

The City received \$3,386 of insurance recoveries for the year as a result of various accidents involving City property. This amount is included in miscellaneous revenues in the government-wide statements and as other income in the governmental fund financial statements.

NOTE 13 COMMITMENTS AND SUBSEQUENT EVENTS

By June 30, 2011, the Area 2 of the West College Avenue CSO Elimination Project, Phase VI-CDE, was under contract to complete sewer separation and related work in the upper sector of West College Avenue from Chestnut to High Street as well as parallel Linden Street to the south from South Water to Pine, along with cross connecting streets and alleys in this grid. The work was 3.5% complete, using \$358,000 in Environmental Protection Agency earmark funds, \$1,398,000 from two Maryland Department of the Environment sources, with the City completing a total budget estimated at \$1,879,978.

In addition, as of June 30, 2011, the City had been notified of a \$500,000 Community Development Block Grant award, effective June 23, 2011, for the next sewer elimination project, Taylor Street, or Phase VII-A. The legislature had earmarked a \$600,000 grant for this project via the Maryland Department of the Environment, and the City was evaluating a companion loan to supplement available City capital funds for the expected cost of \$2,207,500. Acquisition of rights-of-way and environmental planning efforts were underway in the subject period for this project.

CITY OF FROSTBURG, MARYLAND

NOTES TO THE FINANCIAL STATEMENTS

NOTE 11 COMMITMENTS AND SUBSEQUENT EVENTS - Continued

As of June 30, 2011, the City's Low-Head Hydroelectric Power Project, designed to generate energy from an existing closed conduit raw waterline coming down Big Savage Mountain, awaited a bid opening. The project was using a Rural Utility Service loan authorized up to \$922,510 and a supplemental Appalachian Regional Commission grant of \$500,000 administered by the Maryland Department of the Environment.

In addition, as of April 21, 2011, a \$40,000 grant had been earmarked for the project from the US Department of Energy through the Maryland Clean Energy Center/MD Energy Administration. This project was the subject of a possible rebate from Potomac Edison from its Watt Watchers Custom Applications program, but no decision had been made by June 30, 2011 as to any approval or amount, which was budgeted at \$75,000.

As of June 30, 2011, the City was under contract with a design firm to produce preliminary design drawings in support of the Braddock Road Access and Safety Improvements Project, Phase I project, under the provisions of a master plan approved by the State and designed to adjust an intersection to allow development of key commercial site near Interchange 33 of I-68. The work along the MD 736 corridor, Braddock Road, is supported by a \$500,000 Appalachian Regional Commission Local Access Road program grant approved early in City Fiscal Year 2011, with the balance of \$625,000 from the City and \$25,000 from a private partner, the Woda Group. On June 22, 2011, the City was awarded an additional \$400,000 Local Access Road ARC grant, to be matched with \$100,000 of additional City funds for a companion Phase II project to complete additional road widening and drainage adjustments in this area to allow for additional lanes supporting the future intersection. Finally, a Phase III project had been proposed to the Development District for a final allocation (80% of \$500,000) from the ARC to finish the road widening and drainage improvements portion of the master plan along Braddock Road. An ARC decision to authorize an application had not been finalized.

As of June 30, 2011, the City had completed procurement and opened bids under an RFQ process to acquire LED retrofit kits to replace high pressure sodium luminaires in several of the City's streetlight services pursuant to a \$45,000 Energy Efficiency and Conservation Block Grant award from the US Department of Energy allocated through the Maryland Energy Administration.

As of June 30, 2011, the City had completed procurement with Kiddy's Contracting to construct the City Square landscaped parking facility and received a first invoice from the contractor for \$50,850. The project is funded with a partnership with the Maryland Community Development Block Grant program (US Department of Housing and Urban Development, Small Cities) which approved an award of \$100,000 from the Economic Development set aside toward this downtown improvement project which adds 18 new parking spaces and creates a setting for public events near in the downtown business district.

CITY OF FROSTBURG, MARYLAND

NOTES TO THE FINANCIAL STATEMENTS

NOTE 11 COMMITMENTS AND SUBSEQUENT EVENTS - Continued

As of June 30, 2011, the City had just received a grant agreement from the Maryland Community Development Block Grant program (US Department of Housing and Urban Development, Small Cities) awarding \$300,000 for the Frostburg Fire Department Station #1 Retrofit Project, to assist a local capital project to relocate the outdated Station #1 to a newly acquired warehouse by adaptive reuse. Effective date of this grant was set at June 30, 2011. A Subrecipient Agreement between the City and the Fire Department was executed June 30, 2011, setting forth the relationships for this project to be completed in fiscal year 2012.

As of June 30, 2011, the City was in the final stages of completing an extended planning project supported by an Appalachian Regional Commission grant and an amendment to a preexisting Maryland Community Development Block Grant program (US Department of Housing and Urban Development, Small Cities) Planning Grant to complete a Sustainable Communities and Downtown Revitalization Planning project with \$45,000 in ARC funds, \$15,000 from State CDBG Program, and the balance by City to at least \$90,000. The ARC had approved an extension for the final report to July 31, 2011. The work includes completing a major Comprehensive Plan update with new Sustainable Community elements, and other planning activities supporting downtown Frostburg and the historic district.

The City extended the agreement with Maryland Environmental Service for the operation of the Frostburg Water Filtration Plant. The five-year extension of the contract has estimated budget totals as follows:

Fiscal Year 2012	\$ 414,006
Fiscal Year 2013	429,820
Fiscal Year 2014	442,324
Fiscal Year 2015	451,516
Fiscal Year 2016	466,713
Total	<u>\$ 2,204,379</u>

The City evaluated subsequent events through November 10, 2011 for possible inclusion in the financial statements and for potential required disclosures.

CITY OF FROSTBURG, MARYLAND

**STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
BUDGET AND ACTUAL
GENERAL FUND
FOR THE YEAR ENDED JUNE 30, 2011**

	Unrestricted			
	Budgeted Amounts		Actual	Variance With
	Original	Final	Budgetary Basis	Final Budget Positive (Negative)
REVENUES				
Taxes				
Net property tax revenue	\$ 2,047,700	# \$ 2,059,700	\$ 2,097,336	\$ 37,636
Income taxes	400,000	500,000	447,969	(52,031)
Hotel motel tax	150,000	150,000	140,747	(9,253)
Highway use tax	37,000	37,000	33,954	(3,046)
Other taxes	108,400	176,400	179,122	2,722
Police protection grant	76,050	76,050	86,306	10,256
Public safety revenue	66,000	65,100	43,297	(21,803)
Licenses and permits	53,000	38,000	39,350	1,350
COPS grants	30,000	6,000	5,406	(594)
Rental program revenue	66,000	73,000	72,962	(38)
Recreational activities	55,000	55,000	74,535	19,535
Grant income - other	25,700	98,500	197,496	98,996
Transfers from other funds	250,230	302,152	302,152	-
Other income	211,300	104,300	166,127	61,827
Interest	10,000	5,000	3,520	(1,480)
TOTAL GENERAL FUND REVENUE	3,586,380	3,746,202	3,890,279	144,077
EXPENDITURES				
Administration	800,765	880,300	892,356	(12,056)
Public safety	1,465,440	1,445,641	1,441,050	4,591
Street department	904,700	974,626	1,002,499	(27,873)
Recreation department	415,475	445,635	502,754	(57,119)
TOTAL EXPENDITURES	3,586,380	3,746,202	3,838,659	(92,457)
EXCESS OF RESOURCES OVER CHARGES TO APPROPRIATIONS	\$ -	\$ -	\$ 51,620	\$ 51,620

Explanation of Differences between Budgetary Inflows and Outflows and GAAP Revenues and Expenditures

Sources/inflows of resources

Actual budgetary basis "general fund revenue" from the budgetary comparison schedule	\$ 3,890,279
Differences - budget to GAAP:	
Transfers from other funds are inflows of budgetary resources but are not revenues for financial reporting purposes.	(302,152)
Proceeds from the sale of capital assets is income from budgetary resources but are not revenues for financial reporting purposes.	(13,000)
Rental income is income from budgetary resources but are not revenues for financial reporting purposes.	(91,831)
Total revenues as reported on the statement of revenues, expenditures, and changes in fund balance - governmental funds	\$ 3,483,296

The accompanying notes are an integral part of these financial statements.

CITY OF FROSTBURG, MARYLAND
NOTES TO REQUIRED SUPPLEMENTAL INFORMATION

NOTE 1 BUDGET TO ACTUAL VARIANCES

Administration expenses exceeded the final budgeted figure as a result of payments to the Maryland State Retirement System. The expenditure was higher than the budgeted figure.

The street department expenditures exceeded the final budgeted amount as a result of the payout for accumulated time for an employee who retired during the fiscal year.

The recreation department expenditures exceeded the final budgeted figure as a result of the loss of State grant revenues for completed projects. The receivables had to be written off in the current year. The loss was not included in the budgeted figure.

CITY OF FROSTBURG, MARYLAND
REQUIRED SUPPLEMENTAL INFORMATION (UNAUDITED)

SCHEDULE OF FUNDING PROGRESS - OTHER POST-EMPLOYMENT BENEFIT PLAN CONTRIBUTION

Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability	Funded Ratio	Unfunded Actuarial Accrued Liability (UAAL)	Annual Covered Payroll	UAAL as a Percentage of Covered Payroll
7/1/2010	\$0	\$138,183	0.0%	\$138,183	\$1,644,898	8.4%

The City has elected to apply GASB Statement Number 45 prospectively and as a result the liability at transition was \$0.